G-002/M-92-516 ORDER APPROVING DEMAND-SIDE MANAGEMENT FINANCIAL INCENTIVE PLAN WITH MODIFICATIONS AND REQUIRING FURTHER FILINGS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
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In the Matter of the Proposal of Northern States Power Company's Gas Utility for a Demand-Side Management Incentive Mechanism

ISSUE DATE: January 7, 1993

DOCKET NO. G-002/M-92-516

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PROCEDURAL HISTORY

On April 10, 1991, the Commission issued its ORDER SOLICITING COMMENTS in Docket No. G-999/CI-91-188, In the Matter of a Summary Investigation into Financial Incentives for Encouraging Demand-Side Resource Options for Minnesota Gas Utilities. In that Order the Commission initiated an investigation into financial incentives for encouraging demand-side resource options for gas utilities.

On October 18, 1991, the Commission issued its ORDER REQUIRING GAS UTILITIES TO FILE FINANCIAL INCENTIVE PROPOSALS in the aforementioned docket. In that Order the Commission required all Minnesota gas utilities (except Midwest Gas, which was already implementing a financial incentive pilot program) to file demand-side management (DSM) programs on or before June 1, 1992.

On May 29, 1992, Northern States Power Company's Gas Utility (NSP Gas or the Company) filed its proposal for a DSM financial incentive program.

On August 27, 1992, Minnesotans for an Energy Efficient Economy (ME3) filed comments regarding the Company's proposal. The Department of Public Service (the Department) and the Residential Utilities Division of the Office of Attorney General (RUD-OAG) filed comments on August 31, 1992.

The matter came before the Commission on November 12 and December 10, 1992.

FINDINGS AND CONCLUSIONS

I. The Financial Incentive Proposal Submitted by NSP Gas

The financial incentive proposal filed by NSP Gas contained three basic parts: a carrying charge for the Company's conservation improvement program (CIP) tracker account; recovery of lost margins due to conservation expenditures; and a "performance-based earnings adder" incentive. The Company also requested that the Commission consider the concept of a monthly adjustment clause for DSM cost recovery.

In a previous docket, the Commission had approved a CIP tracker for NSP Gas. CIP expenditures and revenues are deferred by the Company and tracked in this account, until the balance is submitted for potential recovery in the Company's next general rate case. To date, NSP Gas had not been allowed to apply a carrying charge to positive or negative balances in the tracker account. The Company now requested approval of a carrying charge to be applied at the rate of the Company's currently authorized rate of return.

The Company also requested recovery of 100% of its lost margins due to conservation expenditures. The Company projected $235,005 in lost margins for the 1993 CIP year (from October 1 through September 30), which would be incorporated into the CIP tracker at the rate of $19,834 (or one-twelfth of the projected total) per month. The balance would be adjusted each May 1, at the time of other annual CIP filings, to reflect actual savings due to conservation. These savings would be measured using a pre/post consumption analysis of program participants as compared to a control group of non-participating customers with similar usage patterns. NSP Gas proposed using weather-normalization factors in its calculations of actual savings.

The third element of the Company's financial incentive proposal was a "performance-based earnings adder" to be applied to its DSM programs. This bonus proposal would be calculated as a percentage of total costs, based on NSP's achievement of participation goals in its DSM programs. If NSP achieved at least 50% of its participation goals, the bonus formula would be applied as follows:

Bonus = (0.1 x [Performance Ratio]) x Program Costs

If NSP failed to achieve 50% of its participation goals, the penalty formula would be applied as follows:

Penalty = (0.1 x [Performance Ratio] - 5%) x Program Costs

The Company proposed that the bonus be capped at 12% of program costs for achievement of more than 120% of participation goals, and that the penalty be capped at 2% of program costs for achievement of less than 40% of participation goals.

The Company proposed factoring cost-effectiveness into the incentive by determining a weighted participation rate. Projects would be weighted according to their allocation of the total authorized CIP budget. Weighted participation rates would be used to determine the amounts of bonuses or penalties.

Under the Company's plan, NSP would track a projected bonus monthly at the rate of 10% of the 1992/92 CIP budget. NSP would adjust the tracker on May 1 of each year to reflect actual bonuses or penalties.

II. Comments of the Parties

<u>The Department</u>

In its comments, the Department discussed its general criteria for assessing proposals for financial incentives. Those criteria included lack of conflict with Minnesota statutes or rules, contribution to diversity in incentive mechanisms, a performance basis for recovery, and administrative practicality.

After applying its criteria to NSP's proposal, the Department proposed several modifications to the financial incentive plan: NSP should provide an annual, not a monthly, accounting of lost margins and bonus; NSP should not be allowed to recover lost margins through rate adjustments between rate cases; there should be a more specific performance component built into NSP's incentive proposal; and recovery should be on a project-by-project rather than on an overall program basis.

The Department recommended that the Company calculate lost margin recovery and bonus amounts on an annual rather than a monthly basis because it believed the Company's proposed monthly method could overestimate energy savings. After the Company made its annual filing, any amounts approved by the Commission would accrue to the tracker.

The Department stated that the Company should not recover CIP-related costs between rate cases because there are only two types of rate changes allowed between rate cases: changes reflecting fluctuations in gas costs; and in some instances, rate changes reflecting taxes, fees and permits. Since monthly adjustments for conservation recovery do not fall into these categories, the Department argued that they could not take place.

The Department recommended that NSP's proposal be modified by strengthening the performance component. Under the Company's proposal, it would receive a bonus of 6% of program costs for achieving only 60% of its participation goals. If the Department's modification were adopted, the Company would receive no bonus for achieving anything less than 100% of participation goals. The Company would be eligible for a bonus of 5% if it reached 100% of its participation goals; the bonus would be 10% if 110% of participation goals were met. If the Company fell below 50% of its participation goals, it would not receive either a bonus or lost margin recovery; lost margin recovery would be 50% at 50% of participation goals, and 100% at 75% of participation goals. The Department stated that its version of a performance component would better link incentive to performance, would better achieve symmetry within the model, and would promote diversity between this and other financial incentive models.

Finally, the Department recommended that NSP determine lost margin recovery and bonuses on a project-by-project basis rather than on an overall program basis. According to the Department, basing calculations by individual projects would give NSP the incentive to manage each project to its full potential and would eliminate the need for weighting factors.

The RUD-OAG

The RUD-OAG noted with approval that NSP considered weather-sensitive usage when calculating usage savings and resulting lost margins.

The RUD-OAG recommended that the possibility of a penalty be removed from the performance component of NSP's proposed performance-based earnings adder. The RUD-OAG felt that the possibility of a penalty for falling below goals could act as a disincentive for the Company. The RUD-OAG recommended that the bonus be based on conservation results achieved rather than participation rates, and that it be calculated as a percentage of lost margins rather than conservation expenditures. According to the RUD-OAG, bonuses should range from 110% of lost margins for achieving at least 50% of energy savings goals, to 125% of lost margins for achieving 100% or greater of energy savings goals.

The RUD-OAG agreed with the Department that a monthly recovery of conservation expenditures is not permissible under current Minnesota statutes or rules.

Minnesotans for an Energy Efficient Economy

Minnesotans for an Energy Efficient Economy (ME3) is a coalition of energy conservation providers, community groups, religious organizations, and other entities. In its written comments, ME3 stated that NSP should only be reimbursed for lost margins for conservation impacts above those projected in NSP's last rate case. ME3 argued that sales growth can offset conservation impact, rendering recovery of lost margins unjustified.

ME3 did not favor the concept of a bonus for meeting DSM participation goals. ME3 also argued that using a cost-weighted performance measurement could lead to "gold-plating," the practice of investing in the most expensive, least efficient DSM so that a utility can earn a return on its DSM expenditures while maintaining sales levels. ME3 proposed a matrix which would base lost margin recovery on a combination of performance and cost-effectiveness standards.

NSP

In its reply comments, the Company noted that it had not specifically proposed the recovery of conservation expenditures between rate cases, and was not asking the Commission to rule on the legality of such a proposal in this docket. The Company suggested that the Commission facilitate an intervenor/utility task force to explore inter-rate case recovery, either under current law or under proposed statutory changes.

The Company did not oppose the RUD-OAG's recommendation that lost margin recovery require achievement of 50% of goals, or the Department's recommendation that lost margins and bonus amounts be booked annually, not monthly. The Company objected to the RUD-OAG's recommendation that the bonus be linked to energy savings rather than participation goals. According to the Company, energy savings results can be skewed by customer lifestyle changes or business changes.

III. Commission Analysis

Carrying Charges

In other dockets, the Commission has consistently found that a carrying charge added to a CIP tracker account is an equitable means of adjusting actual CIP expenditures to CIP projections. Any differences between projected and actual expenditures will be tracked in the account and will be adjusted in the utility's next general rate case. If a company has underprojected, however, it will not be made whole if it simply receives the dollar amount of the undercollection in the next general rate case. Carrying charges can make a utility whole for the value of the use of the money it has "lent" to the conservation program, until the next adjustment. By the same token, carrying charges can make ratepayers whole if they have inadvertently "lent" money to the company through overcollection between rate cases.

The Commission will apply this reasoning to this docket and will allow NSP to apply carrying charges to its CIP tracker account.

Lost Margin Recovery

In previous decisions in other dockets, the Commission has followed its legislative directive to emphasize and promote DSM and conservation programs in general. The Commission has found that allowing recovery of lost margins reduces the obstacle of regulatory lag and thus encourages conservation. Recovery of lost margins can lessen the need of utilities to file frequent general rate cases. For these reasons, the Commission will approve the Company's proposed recovery of 100% of lost margins due to conservation expenditures.

The Commission does not agree with the Department or the RUD-OAG that a performance component should be built into the Company's mechanism for recovery of lost margins. The Commission has addressed the issue of a performance basis for DSM lost margin recovery in previous dockets. In its Order approving Minnesota Power's DSM financial incentive proposal[1], the Commission stated:

> The Department urged the Commission to tie Minnesota Power's recovery of lost margins to achievement of its CIP goals. The Department is rightly concerned with performance; **** The Commission believes, however, that for purposes of this pilot project, limiting recovery to margins actually lost due to conservation adequately ties recovery to performance. Only when energy has been saved will the Company recover lost margins.

The Commission finds that recovery of 100% of lost margins need not be linked to performance goals. Achievement of performance goals is intrinsic to the Company's lost margin proposal; if margins are not lost due to lower sales, which are in turn due to conservation expenditures, there is no basis for recovery. For these reasons, the Commission will allow the Company 100% lost margin recovery, without a performance component.

The Commission also finds the Company's means of measuring and tracking lost margins appropriate and reasonable. Tracking one-twelfth of the projected lost margins each month, with a true-up each May, is an acceptable method. The Company's lost margin measurement, including the application of a weather normalization factor, is also reasonable.

Bonus Incentive

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[1] In the Matter of the Proposal of Minnesota Power for a Demand-Side Management Incentive, Docket No. E-015/M-91-458, ORDER ESTABLISHING DEMAND-SIDE MANAGEMENT FINANCIAL INCENTIVE PILOT PROJECT AND REQUIRING FURTHER FILINGS, March 12, 1992.

The NSP Gas incentive proposal would provide a bonus, calculated as a percentage of program costs, for achievement of certain levels of its participation goals. The Commission finds that the modifications to the Company's proposal recommended by the RUD-OAG are reasonable and should be adopted.

The Commission agrees with the RUD-OAG that bonuses should be applied against lost margins, not program costs. Lost margins represent the contribution to fixed costs and the profit which are lost to the Company through participation in conservation programs. Lost margins also represent energy savings results achieved. It is fitting, therefore, to apply the percentage of the bonus earned against lost margins. Applying the bonus to lost margins rather than conservation costs also eliminates a utility's possible incentive to spend indiscriminately on conservation costs so that the bonus percentage will be applied to higher costs. The Commission will modify the Company's incentive proposal to apply the bonus percentage to lost margins.

The Commission will adopt the RUD-OAG's performance measurement by which bonuses are determined. Basing the measurement on actual energy savings achieved rather than participation is appropriate in this bonus situation. Performance measurements based on participation levels are meant to measure roughly the success of conservation projects; the RUD-OAG's method of measurement rewards the actual ultimate goal of conservation projects, energy savings.

If NSP Gas achieves 50-100% of its energy savings goal, it will receive a 10% bonus calculated on actual lost margins. If the Company achieves more than 100% of its goal, it will receive a 25% bonus applied to lost margins. The bonus would be in addition to recovery of 100% of lost margins, and would be capped at 120% of the program goal.

Miscellaneous Administrative Matters

The Commission will approve NSP's proposal, as modified, as a two year pilot project. Two years should provide the Company, the Commission and Department with sufficient time to assess the proposal, while maintaining the experimental, innovative nature of DSM proposals.

The Commission will allow the Company to book estimated lost margins to the tracker on a monthly basis, subject to a May 1 annual true-up. The Commission will not, however, allow the Company to book estimated bonus amounts on a monthly basis. The Company will be required to prove that any bonus amounts have been actually earned before they are booked to the tracker. If the bonus amounts are approved, they may be booked on May 1 along with other CIP annual filings.

The Department argued that conservation projects usually produce only half the savings in their first year of implementation, compared with ensuing years. The Department therefore reasoned that allowing NSP to book lost margins in a program's first year in the same way it will book them in subsequent years could lead to overestimating. The Department recommended that NSP make an annual filing based on information from its May 1 CIP status report, in which it would calculate actual energy savings and lost margins from its conservation projects. These calculations would consider the reduced savings from current-year projects. Subsequent to approval of the filing, the Company would be allowed to book its lost margins in the manner set out in the preceding paragraph.

Finally, to assist the assessment of this pilot project, the Commission will require the Company to file a plan evaluating the impact of the incentive on the Company's investment in cost-effective conservation.

ORDER

1. A carrying charge set at the Company's last approved rate of return shall be applied to the Company's CIP tracker account.

2. The Company's DSM financial incentive proposal, as modified in this Order, is approved as a two year pilot program.

3. Within 45 days of the date of this Order, the Company shall file a plan for evaluating the DSM financial incentive pilot project.

4. On or before May 1 of each year, the Company shall file a report detailing collections and expenditures in the DSM tracker account, a calculation of actual energy savings and lost margins, carrying charges, bonuses and penalties for the previous year. The report should consider the reduced savings from current-year projects.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

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